

***United States Court of Appeals
for the Second Circuit***



**APPELLANT'S
REPLY BRIEF**

77-6095

9/19

To be argued by
VICTOR S. GOMPERTS

In The
United States Court of Appeals
For The Second Circuit

AMERICAN TELEPHONE AND TELEGRAPH COMPANY,
Plaintiff-Appellant,

-against-

THE UNITED STATES OF AMERICA,
Defendant-Appellee.

Appeal from the United States District Court for the Southern
District of New York.

**REPLY BRIEF FOR
PLAINTIFF-APPELLANT**

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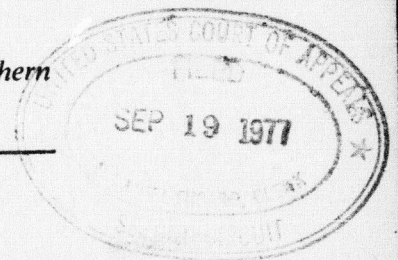


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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

Docket No. 77-6095

AMERICAN TELEPHONE AND TELEGRAPH
COMPANY,

Plaintiff-Appellant,

- against -

THE UNITED STATES OF AMERICA,

Defendant-Appellee.

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

REPLY BRIEF FOR PLAINTIFF-APPELLANT

AT&T, in reply to Defendant-Appellee's brief dated
September 7, 1977 ("Appellee's Brief"), makes the following
points for the purpose of correcting the Government's

mischaracterizations of AT&T's position:

POINT I

In Appellee's Brief at 16, the footnote sets forth an example where 1,000 Canadian dollars are paid as taxes when the Canadian and American dollars are equal in value and 500 Canadian dollars are refunded at a time when 1 Canadian dollar equals \$1.25. Appellee's Brief states that "AT&T's approach would value the refund at \$500 and would treat the \$125 difference between that amount and the \$625 actually received as a foreign currency gain for the year of refund." (Appellee's Brief, n. 16). In truth, AT&T's brief, which sets forth exactly the same hypothetical, reaches the following conclusion:

"The refund is valued as of the date of refund and is equal to \$625. (500 Canadian dollars x \$1.25). ...[T]he taxpayer's original foreign tax credit of \$1000. is reduced by \$625., leaving a net foreign tax credit of \$375. (Appellant's Brief at 13-14).

Furthermore, there is no suggestion by AT&T in its discussion of this hypothetical in its brief that any amount be treated as a foreign currency gain in the year of refund.

Apparently, the only way the Government could find a basis to argue that "AT&T's approach results in an inconsistent construction of Section 905(c)" Appellee's Brief at 16, was to invent and attribute to AT&T an "approach" which does not exist in AT&T's brief. The approach which is falsely attributed to AT&T by the Government does result in an

inconsistent construction of Section 905(c). The approach actually taken by AT&T, i.e., one where the taxpayer and the Government share the risk of foreign currency fluctuation so long as the refund does not exceed the original tax credit claimed, is a consistent and equitable construction of Section 905(c).

POINT II

The Government seeks to further obscure the issue in this case by its inaccurate analysis of another hypothetical set forth in its brief. See Appellee's Brief at 12-13. This hypothetical assumes that a taxpayer earns 2,000 in Canadian dollars, 1,000 of which is taxable under one section of the Canadian Tax Act and 1,000 of which is taxable under a different section of the Canadian Tax Act. The example further assumes that the American and Canadian dollar are equal in value, and that both Canada and the United States have tax rates of 50%. Under these assumptions, the total tax paid to Canada is 1,000 Canadian dollars (500 dollars of Canadian tax under each section of the Canadian Tax Act) and the foreign tax credit is worth \$1,000. A further assumption is made that Canada refunds 500 Canadian dollars of tax, paid pursuant to one of the two sections of the Canadian Tax Act, at a time when the Canadian dollar equals \$1.25.

In applying the "AT&T approach" to this hypothetical, the Government determines an effective tax rate of 44% "which provides the taxpayer with a windfall" - Appellee's Brief at 13. In truth, the AT&T approach which applies Section 905(c)

in a logical manner, results in a 50% tax rate - exactly the same as the Government's approach. Under the AT&T approach, \$500 of the \$1,000 foreign tax credit would be eliminated as a result of the refund and the taxpayer would be taxed on the remaining \$250 foreign currency gain. The taxpayer would thus pay \$625 in income tax to the United States ($\$500 + (50\% \times \$250) = \$625$) and \$500 in tax to Canada for a total of \$1,125 with respect to an income of \$2,250 ($\$2,000 + \250 currency gain). This represents an effective tax rate of 50% - not 44% as alleged in the Government's brief.

Appellee has been misled by its own assumption that because the 500 Canadian dollar tax refund is worth \$750, as a result of fluctuating currency rates, that after the refund the taxpayer has only paid \$250 of tax to Canada. In truth, after the refund, the taxpayer has paid \$500 in tax to Canada and realized a \$250 foreign currency gain which is properly taxed in the year of refund, i.e., the year in which the gain is realized.

That the Government's approach is not logical can be illustrated by slightly altering the above hypothetical. Assume that only 500 dollars of tax is paid to Canada and the other 500 dollars of tax is paid to Germany with a subsequent refund of the German tax at a time when the German refund is worth \$750. The Government's approach, which fails to analyze the separate foreign taxes paid, would subtract the \$750 refund from the \$1,000 tax credit and the taxpayer would be left with a \$250 tax credit even though it unquestionably paid \$500 of tax to Canada. An

approach which would yield such an anomalous result must be rejected. If the approach urged by AT&T is adopted, \$500 of the \$1,000 tax credit (the amount representing the original payment of the German tax) would be eliminated and the \$250 foreign currency gain would be taxed in the year of receipt. The taxpayer would thus be left with \$500 of tax credit which represents the tax paid to Canada. Again, on an income of \$2,250 (\$1,000 from Canada + \$1,250 from Germany) the taxpayer would pay a total of \$1,125 tax (\$500 to Canada and \$625 to the United States) for an effective tax rate of 50%.

CONCLUSION

For the reasons stated above and in the Brief for Plaintiff-Appellant dated August 2, 1977, it is respectfully requested that the order of the District Court granting defendant-appellee's motion for summary judgment be reversed, and that judgment be awarded to plaintiff-appellant.

Dated: New York, New York
September 20, 1977

Respectfully submitted,

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COURT OF APPEALS

SECOND CIRCUIT

AMERICAN TELEPHONE AND TELEGRAPH
COMPANY,

Plaintiff-Appellant.,

- against -

UNITED STATES OF AMERICA,
Defendant-Appellee

Index No.

Affidavit of Personal Service

STATE OF NEW YORK, COUNTY OF

SS.:

I, James A. Steele being duly sworn, depose and say that deponent is not a party to the action,
is over 18 years of age and resides at 112 West 136th Street; New York, New York

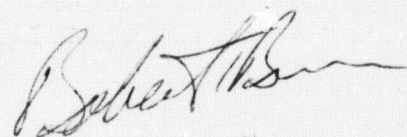
That on the 19th day of Sept., 19 77 at One St. Andrews Plaza
New York, New York
deponent served the annexed upon

Reply Brief

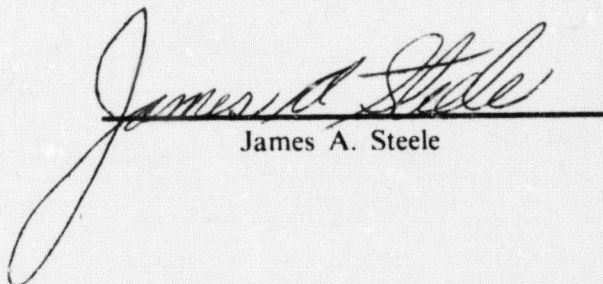
Thomas Moseley, U.S. ATTY

the in this action by delivering a true copy thereof to said individual
personally. Deponent knew the person so served to be the person mentioned and described in said
papers as the herein,

Sworn to before me, this 19th
day of Sept., 19 77



ROBERT T. BRIN
NOTARY PUBLIC, State of New York
No. 31-0418950
Qualified in New York County
Commission Expires March 30, 1978


James A. Steele